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THE MASSACHUSETTS TAX REPORT.

THE report of the Massachusetts Tax Commission¹ of 1896, recently submitted, is a noteworthy document. It marks the highest point yet reached by an American commission in the discussion of problems of state and local taxation. Among the two score of American reports on taxation it is distinguished by its statesmanlike grasp of fundamental problems and principles, and its scholarly acquaintance with modern ideas. Other reports occasionally surpass it in the treatment of special questions. The New York report of 1871 went much deeper into the legal intricacies of taxation. The Ohio report of 1893 treats more fully of the methods of taxing corporations. But none has gone so directly to the heart of the whole subject and occupied itself so exclusively with salient features. This was, no doubt, chiefly due to the character of the commission, in the composition of which rare judgment was shown. The commission was not a committee of the legislature, but was appointed by the governor from persons who seemed particularly suited to help in its work. The bench, the business community, the farmers, the workingmen, the professional students of taxation, were, each, represented by a member on the commission — the last named through Professor Taussig, of Harvard University.² It was an unusual commission, therefore; and, having undertaken its work in a large spirit, its conclusions are of more than local interest. No apology seems necessary for presenting them to the readers of the JOURNAL somewhat at length.

The situation, industrial and fiscal, of Massachusetts, is not so different from that of the other states as to limit seriously the serviceableness of the commission's investigations. Massachusetts is a state with manufactures and commerce the best established pursuits of the

¹ *Report of the Commission Appointed to Inquire into the Expediency of Revising and Amending the Laws of the Commonwealth Relating to Taxation.* Boston: State Printer, 1897.

² The other members of the commission were Judge J. R. Dunbar, Hon. Alvan Barrus, Hon. T. Jefferson Coolidge, and Mr. George E. McNeill. The majority report was signed by all the members excepting Mr. McNeill, who represented the workingmen, and who submitted a separate report.

people, and agriculture in a condition of decline. The proportion of urban communities is larger than in most of the states, as is also that of the capital invested by her citizens in enterprises outside of the state. But these circumstances, after all, simply serve to bring into relief the principal conditions that have to be reckoned with in the reform of American taxation, in all but the strictly farming states. The Massachusetts tax system bears a general resemblance to that of the other states, although possessing some distinctive features. The general property tax is the basis of the system. Mortgages, however, on Massachusetts real estate are not taxable as personal property and, practically, they are exempt. But securities of corporations outside the state are taxable. Besides the general property tax and, indeed, partly as supplying its deficiencies, other important sources of revenue have been established. These are the corporation taxes, the income tax on professional and business incomes, and a collateral inheritance tax. Corporations are taxed locally on their real estate and machinery, but these are deducted in determining the state tax. The proceeds of the latter (known as "corporate excess") are distributed in large part among the cities and towns.

The assessment of taxes in Massachusetts is better than in most of the states, the administration being more centralized and a higher standard of efficiency among the officials maintained. A more or less effective supervision of valuations in different parts of the state is exercised by a tax commissioner. The results obtained, therefore, represent as much as may be expected from a system in which the general property tax figures as the most important element. They are so far from satisfactory, however, that the commission has found it necessary to recommend important changes. These changes are summarized as follows :

1. An inheritance tax, levied with respect to realty as well as to personality, at the rate of 5 per cent., with an exemption for estates not exceeding \$10,000, and an abatement of \$5000 on estates between \$10,000 and \$25,000. The revenue from this tax to be distributed from the state treasury among the several cities and towns, one-half in proportion to population, one-half in proportion to assessed valuation.

2. A tax on occupiers in proportion to house rentals, only the excess over \$400 of rental being taxable.

3. Abolition of the present taxes on intangible personality, such as stocks, bonds, loans on mortgage, income ; the taxes recommended

under 1 and 2 being relied on to yield at least as large a revenue as is now secured by the taxes to be abolished.

4. Assumption by the state treasury of county expenses.

5. Appropriation by the state of the revenue from taxes on corporate excess, now distributed among the several cities and towns.¹

It may be added, that the abolition of taxes on intangible personalty is to extend to investments, without as well as within, the state; that the house rentals tax is to be for local purposes; that the corporate excess to be appropriated by the state is to provide for the assumption of county expenses; and, finally, that the commissioners favor, though they do not recommend, the exemption of machinery from taxation. The rate proposed for the inheritance tax is 5 per cent., for the house rentals tax 10 per cent.

Striking, not to say radical, changes are, therefore, contemplated by this plan, although the general attitude of the commission is conservative.² The general effect of the plan, if adopted, will be a serious alteration in the distribution of the burdens and benefits of taxation in the state. For there will be benefits as well as burdens to be distributed under the new system. Two leading thoughts appear to have shaped the recommendations of the commission. One, to secure a more equitable distribution of taxation among the various classes and interests affected; the other, to use the general financial resources of the state for the relief of certain localities now overburdened. Hence the proposed assumption of county expenses, and hence, also, the proposed division of the proceeds of the inheritance tax. The commission took its position on the principle that persons of means should make full contributions to the public charges in proportion to their means, whatever the form or source of those means;³ and sought to frame a system in accordance with it. "To bring this about with the least possibility of evasion, without a shifting of taxes to the shoulders of others, without annoying and objectionable inquisition into the private affairs of citizens," the commission recognizes, "is the most difficult problem in taxation."⁴ While completeness cannot be claimed for its solution, it does show a remarkably clear conception of the task to be dealt with and its difficulties. And the commission has probably

¹ *Report of the Commission*, p. 120.

² "Changes in the methods of taxation should not be made unless strong cause for them can be shown, and great gains can be reasonably expected."—*Ibid.*, p. 39.

³ *Ibid.*, pp. 95, 111.

⁴ *Ibid.*, p. 95.

acted wisely in confining its recommendations to what seems necessary to overcome the acknowledged evils of the existing system, while substituting in its place one that will be more equitable and yet workable. Altogether, the plan under review presents a consistent and well-considered attempt to grapple with the problem of state and local taxation, regarded as a whole. This is its special distinction.

The first, and the essential, step in the reform of American taxation, it is now agreed by all competent students of the problem, is the abandonment of the attempt to tax intangible personality. There are those who propose to go even further in the disintegration of the present system, by reducing the general property tax to a simple real estate tax,—what it is getting to amount to, more and more, in practice. But on this point the consensus of opinion is not yet complete, although there is a noticeable drift in this direction. The Massachusetts commission, however, has limited its proposal to the lesser step; but its recommendation, here, is explicit and unqualified. No such explicit proposal to give up taxes on intangible personality has ever been made in the majority report of an American commission, excepting the New York report of 1871 and the Ohio report of 1893. The Massachusetts commission of 1875, in an otherwise able report, recommended the retention of the taxes on personality, confident that it could be reached if more effective measures were adopted; and the more recent commission of 1893 contented itself with recommending a compulsory listing system backed by severe penalties. And such is the view of most recent commissions in other states. The Maine commission and the Pennsylvania commission, both of 1889, advise more stringent methods. The Delaware commission of 1891 even had the hardihood to propose the reintroduction of the tax on intangible personality. But, generally, the unsatisfactoriness of the tax is admitted in the reports, without its being seen that the causes of failure are inherent in the system and that the only logical escape lies in a change of system. Thus, the New York Counsel Report of 1892 thinks abolition too radical a step. The principle of the property tax has evidently taken a firm hold of the average American mind, and it is clear that emancipation will be neither a swift nor an easy process. Each new accession to the ranks of the abolitionists deserves, therefore, to be signalized; and in the most recent accession we recognize the well-informed judgment of a commission that has inquired into the nature and working of the property tax thoroughly and, having found

the lasting causes of its failure, has not shrunk from the duty of boldly proposing the abolition of its worst feature. We quote from the report:

The taxation of personal property in the form of securities and investments is thus a failure. It is incomplete, uncertain, not proportional to means as between individuals, grossly unequal in its effects on different parts of the state. The experience of Massachusetts in this regard is the same as that of the other states of the Union. Everywhere, without exception, the testimony is that this part of the system of the general property tax is unequal, unsuccessful, often demoralizing to tax officials, always irritating to taxpayers.

The experience of Massachusetts is the more striking, because here the difficulty does not lie mainly in the administration of the tax laws. The assessors are usually honest, competent, zealous. We have heard much of grave abuses, of almost corrupt laxity, in other states. But in this commonwealth, notwithstanding occasional defections, the standard of public duty continues to be high, and the cause of failure is not to be found mainly in official dereliction. It lies in the system itself.¹

The simple system of the general property tax, adopted in the days of simple conditions, is antiquated. The complicated industrial life of modern days calls for a more complex and a more varied system of taxation. No one tax, resting on the apparently simple principle of taxing every man in proportion to what (in the eye of the law) is his property, will meet the difficulties of the situation.²

The logic of the situation, then, demands a change of system. Of this there can be no question. The real matter for discussion relates to the taxes that are to compose the new system. As yet no programme has been settled upon by those who have given most thought to the subject. Nor is such a specific achievement likely to be the result of the discussion. The states of the Union are not all on the same level with respect to resources or requirements; and the local equation must be allowed its full value in the changes to be undertaken, in each case. But the substantial similarity of conditions is large enough to make agreement possible on the fundamental needs of the situation. And this result is being achieved. Anyone who analyzes the reports of the past twelve years can hardly fail to detect the convergence of opinion on certain points that are certain to describe the direction and scope of the future tax system. These points were recently stated to be: separation of state and local revenues; state revenues derived chiefly

¹ *Report of the Commission*, p. 67.

² *Ibid.*, p. 110.

from corporation and inheritance taxes; local revenues derived from real estate and from the other elements of taxable faculty.¹ The changes recommended by the Massachusetts commission are in harmony with these tendencies.

The plan of the commission clearly contemplates a division of the sources of revenue between the state and the localities. Each is to be equipped with its independent taxes. The proposed assumption of county expenses by the state works in the same direction, by drawing, more sharply than is now done, the line between state finance and local finance, and thus emphasizing the propriety of separate revenue provisions. It is a fundamental principle of finance that the revenue system should be adapted to the nature and effect of the public services it is designed to support; and a moment's consideration is sufficient to indicate how different are the spheres of action of state, and of local, government. The services, and the benefits of the services, undertaken by the former are quite different in character from those that are peculiarly local. This difference, in its extreme form, is all the difference between building a university and cleaning an alley; and on this difference is based the important principle of segregation of revenues between the various divisions of government—a principle that is bound to assert itself in any serious analysis of the data of state and local finance. It is already becoming a noticeable tendency of modern taxation, it was the operative principle of the recent Prussian reforms, its influence is felt in American discussions. The deeper reasons from which the principle derives its sanction are not yet appreciated by American commissions. The heavier financial needs of the cities, and the difficulties of administering an identical state and local tax system, are the considerations that have thus far determined their views. But the principle is at work among us and represents, just now, the most fruitful idea in American finance. It has helped shape the plan of the Massachusetts commission, although the separation of local from state taxation is not carried as far in that plan as some recent commissions have wished. The division under the new system would be the following :

State	Local
1. Corporation taxes.	1. Inheritance tax.
2. Property tax.	2. Habitation tax.
	3. Property tax.

¹ SELIGMAN, *Essays in Taxation*, p. 420.

The line of cleavage, it will be observed, would be broken by the use of the property tax for both state and local purposes. Its chief rôle, however, would be in local finance, since the state treasury would look to the corporation taxes and other fixed sources for the great bulk of its income. It would seldom be necessary for the state to carry its rate on property beyond a very moderate height. Being so largely local in effect, therefore, why not have made it so in law? From a "wish to retain," says the commission, "in the expenditure of the public revenues that sobering sense of responsibility which arises with the need of a levy of immediate taxes." Economy in the use of the public money is certainly an object worth aiming at in the financial system, and it will always deserve consideration, whether the particular method alluded to is not efficacious for the purpose, though there are those who scout the idea as a fiction of the books. However this may be, it certainly seems unwarranted by experience to put much faith in the method, where the margin of expenditure to be provided by immediate taxes is so narrow as it would be in Massachusetts. The average American taxpayer is not very sensitive to moderate changes of rate, and immoderate extravagance is not to be feared. The particular lesson, in the management of public outlay, that this country is most in need of learning, is not so much economy in the amount of expenditure as wisdom in the choice of objects. We spend not too much, but with too little sense of proportion. Where the danger of legislative extravagance is real, it would be better, if the remedy is to be found in taxation at all, to cut it off by limiting state expenditure to the yield of the permanent taxes, establishing the latter at rates that are equal to supplying the regular and ordinary requirements of revenue, but little more. Little inconvenience would be experienced from this practice, because there is little room for variation in the level of legitimate state needs. The objects of state outlay are fixed in character and an easily ascertainable amount, and lend themselves admirably to support out of fixed sources of revenue. Their slow increase would be easily met, in most cases, by the steady growth of the solid sources that would naturally be selected, *e. g.*, a well-arranged system of corporation taxes. There is no need in commonwealth finance as in national finance, of adjustable receipts; no need, therefore, on this account of retaining the state tax on property. Its retention, moreover, would keep alive more or less of the existing friction between the state and the local administration. Such friction is

almost inevitable in any system which apportions a state tax on the basis of local valuations. It is true that the present difficulties in the way of equal apportionment might be diminished by removing the temptation to undervaluations; and this might be accomplished by some such method as that ingeniously suggested by the Massachusetts plan, of distributing a portion of the inheritance tax on the same basis of valuation as that made for the levy of the property tax. With a heavy inheritance tax and a light property tax this would seem to promise an effective method. But it is just conceivable that it might prove too effective and give rise to new complications of a rather serious character. The inheritance tax would offer a tempting melon to be divided, and local cupidity would be stimulated. Overvaluation might follow in the wake of undervaluation, and thus inequality be perpetuated. But even supposing the problem of uniform assessment could be solved in the suggested manner, it must be confessed that property is not an appropriate subject for state taxation. Both theory and experience have marked it for local taxation. It is, especially as regards real property, local in its character and value; its most important relations are with local, not state, activities; it is the recipient of substantial benefits from local government, from which it derives value and for which it should make compensation in equivalent taxes. The doctrine of taxation in proportion to benefits is a reasonable principle in local finance and leads logically to the *local* taxation of property. And, considering the rapid growth of local expenditures, there is an added reason for putting the cities and towns in undisturbed possession of this, their most expedient form of taxation. The state should look elsewhere for its revenue, there is no place in a well-organized modern tax system for a state tax on property.

Turning to the new taxes proposed by the commission, the first to be noted is the inheritance tax. Here is a form of taxation that is rapidly gaining ground at the present time. Recent legislation abounds in examples of its introduction or development. It is a characteristic product of the democratic tendencies of the day. Whenever the pressure for revenue reform is making itself effectively felt, the inheritance tax is making its way. Whatever the misgivings of earlier theorists, its expediency, in some form, is almost unquestioned now; although, it must be admitted, that its popularity is greatest where least is known of the subject of taxation. But this only makes it clearer that the sentiment of the age demands this kind of

taxation, and this sentiment is being respected. While the opinions of scholars are divided as to the true nature and justification of the inheritance tax, its appropriate constitution, its place in the tax system; the legislative movement is steadily growing stronger. More than a dozen states of the Union have some sort of collateral inheritance tax; two also tax in the direct line, and some have attempted to maintain a scale of progressive rates. But, except in a few cases, the yield of the tax is not high. American reformers have thus far had to content themselves with establishing the principle of the tax, leaving its fiscal development to the future. But the Massachusetts commission proposes to make of the inheritance tax an important present financial resource, assigning it a very definite place in the new system. Instead of the few hundred thousands now raised by inheritance taxation, it is proposed to look to this quarter for a few millions. It is to be the main substitute for the existing taxes on intangible personality, and it has evidently been arranged with this object in view. The commission has concerned itself little with the theoretical side of the tax. No gradation of rates according to degree of kinship is recommended, and, beyond abatements for small estates going to mere relatives, no graduation of rates to the size of the inheritance. "Such a scale would raise very difficult questions of principle as to the propriety of discrimination between persons of large and small means, and as to the extent to which the state should go in a method which tends to discourage accumulation."¹ Until these questions have passed the stage of discussion it would seem best to keep the inheritance tax within conservative lines. Indeed, the proposal of the Massachusetts commission, levying, as it would, a practically uniform tax on estates before distribution, really amounts to a property tax levied in the convenient form of an inheritance tax. Inheritance, as such, figures but little in the constitution of the tax. There is nothing objectionable, nothing "punitive" or "confiscatory" about it. It is a simple and effective method of reaching a class of property that now largely escapes. As such it is intelligible and commendable.

Though offered as a substitute for the present taxes on intangible personality, the commission intends that the new tax shall apply indifferently to real and personal estate. On the face of it, this would seem to result in a hardship to the owner of real property and visible personality. This important aspect of the case has not, however, been over-

¹ Report, p. 93.

looked by the commission, at any rate, not as regards real property. Indeed, it is one of the rare merits of the report that it has reckoned with the question of shifting and incidence of taxation. In arranging its system the commission has evidently tried to look forward to the ultimate distribution of its pressure, and no fear is entertained that real estate will be overburdened. In the opinion of the commission, the present owner, in the cities at least, feels the burden of the property tax but little. Partly, the tax has been discounted in the purchase price of the property ; partly, it is shifted to the tenant. In a great many cases, "outlay and rentals are so adjusted that the owner gets a net income equal to that which investments of the same solidity yield in other directions."¹ In such cases the owner has contributed in form only, and may, therefore, fairly be called on for further taxes. As a general proposition this is probably true, and so far strips the inheritance tax proposal of the objection of being an unjust double tax. The same argument, it may be noted, is also applicable to the corporation taxes. There, too, the taxes have been discounted in the price of the stock. The present holder seldom carries their burden. But in the less prosperous towns and in the farming districts there is little shifting of the property tax. There the burden is a real one. In these communities, however, the number of persons who would be reached by the proposed inheritance tax is small, so that no serious inequalities would result—certainly no more than are inseparable from the working of almost any system. Altogether, then, the inheritance tax would cause no aggravation of the burdens of the present taxpayer ; it would, in the main, strike a class of contributors who now avoid their fair share of taxation. The only class that might have ground of complaint is the active business class. Merchants and manufacturers would continue to be taxed on their stock in trade and machinery. They cannot shift their taxes. For them the inheritance tax would be an added burden ; but not necessarily an unjust burden. Their chief contributions under the property tax would be to local taxation, and it is questionable whether they would amount to more than a fair equivalent for the advantages received by them from the local expenditures.

A further feature of the proposed inheritance tax must be noted. The tax is to be collected by the state, through the machinery of the probate courts, but the proceeds are to be distributed in aid of local

¹ *Report*, p. 33.

taxation. In effect, therefore, it would be local revenue. This is a new suggestion in American finance. Hitherto, and in existing legislation, there has been no thought of treating the inheritance tax as other than state revenue to be used for state purposes. In England a substantial fraction of the imperial "death duties" has for some time been allocated to the local authorities; under the recent changes in Prussia, the business tax is administered by the central government on account of the communes; and other examples might be cited. But, thus far, the whole idea of treasury subventions from the higher divisions of government has remained quite foreign to our financial practice. It is worth considering, however, whether this method would not supply an easy solution of some of our most perplexing tax problems. The complications of interstate taxation might be greatly diminished if the federal government should undertake the collection of certain taxes— railroad, telegraph taxes, etc.— and apportion the proceeds among the states on some equitable basis. Uniformity of system would be the gain here. And, within the limits of state finance, the method might be advantageously employed to lighten the burden on local resources. The fact which must not be lost sight of in a study of the tax problem, is the vast preponderance of local over state outlay in the cost of government. It is as six to one, and the disproportion is steadily growing larger.¹ The local divisions are sadly in need of taxes which they are not in position to command. The sources of local revenue are necessarily limited, some of the most productive taxes not being adapted to local administration. Such are inheritance and corporation taxes, and, perhaps, business and mortgage taxes. These should be collected at rates in excess of state requirements, a portion of the proceeds, or all the proceeds of some one, being assigned to the local divisions. In this way the machinery of taxation would be more effectively set in motion, enabling a better adaptation of resources to needs, and relieving the pressure on overburdened districts. Such seems to have been the leading idea of the Massachusetts commission in recommending the distribution of inheritance tax revenue among the cities and towns. And, from this point of view, the proposed basis of apportionment, one-half in proportion to population, one-half in proportion to assessed valuation, is quite satisfactory; although local taxation would be, in some respects, a better

¹The expenditures of the states are stated in the census of 1890 at 77 millions, and those of the local divisions at almost 487 millions.

measure of local neediness than assessed valuation. Details aside, however, the suggestion in its general bearings is one of great practical value, and could be adopted in almost any American state without seriously dislocating existing arrangements.

Much more radical is the proposition for a house rental tax. If adopted, it would mark a striking innovation in our methods of taxation, a wide departure from the principle of the property tax. A similar proposition was made by the New York commission in 1871, but attracted little attention at the time. Its revival now, by the Massachusetts commission, after a quarter-century seems to show that there is something in the idea. Both commissions recommend it as a way of reaching elements of taxable strength that now escape. Taxes on house rent are common in Europe; the local rates are levied on it in England; so, too, the *Mietsteuer* in many German cities; and it is an integral part of the French *impôt mobilier*. Its merits and its defects are well understood, therefore. It is not a tax on property, but on expenditure; it is levied not from the house owner, but from the occupier. But, though a tax on expenditure, it is not open to the objection commonly urged against expenditure taxes, of being unequal. On the contrary, it is upheld by its advocates as being a near approach to an income tax. It is described in the report of the Massachusetts commission as "a tax on presumed or estimated income, proportioned to the expenditure for dwelling accommodation."¹ House rent is simply seized on as a convenient and approximate indication of income. The theoretical desirability of the income tax is generally admitted. It alone is equal to the task of thoroughly securing contribution in proportion to means. But no one at all acquainted with the present situation in this country believes that a state income tax could be successfully enforced. Its collection presupposes conditions that do not exist. "We fear," says the commission, "that no effective public opinion would be present to aid the administration of a state income tax, and that evasion and concealment would take place to so great an extent as to render it ineffective and deservedly unpopular."² The income tax offers no cure, therefore, for the evils of the existing system; and the objects aimed at by the income tax are to be secured, if secured at all, by means better adapted to the exigencies of the situation. This is the rationale of the proposed habitation tax. Perfection is not claimed for it, it is admitted that expenditure for

¹ Report, p. 105.

² *Ibid.*, p. 87.

dwellings is only a rough and uncertain test of income. But, with all its disadvantages, it is contended that better results may be expected from this tax than from any other available method.

It is clear, almost impossible of evasion, easy of administration, well fitted to yield a revenue for local uses, and certain to yield such a revenue. It is clear, because the rental value of a house is comparatively easy to ascertain. The tax is based on a part of a man's affairs which he publishes to all the world. It requires no inquisition no inquiry into private matters ; it uses simply the evidence of a man's means which he already offers. We have provided that a taxpayer may either declare the value of the dwelling he occupies or leave it to be estimated by the assessors ; the matter being one which, in the majority of cases, can be so nearly estimated without declaration by the taxpayer that it is not very material whether he hands in a statement or does not. It cannot be evaded except by change in the style of living, which few people, if any, would undertake because of a moderate tax.¹

These are solid advantages, not to be lightly dismissed. A strong presumption, it must be confessed, is established in favor of any tax that can be easily and uniformly assessed. Nothing but clear proof of unbearable inequality should be allowed to overcome it. It is not strange, therefore, that the house-rentals tax should have won the indorsement of high authority. Mill believes it "a nearer approach to a fair income tax, than a direct assessment of income can easily be." Leroy-Beaulieu thinks it "the best means of striking contributors in proportion to their faculties," and calls it "the most acceptable of the direct taxes."²

The difficulties which would present themselves, if it were proposed to collect this tax for state purposes, fall away where it is restricted to local uses, and make it the more unobjectionable. While between places of different importance or population, the scale of rents would be different, and the correspondence of rent and income, therefore, broken ; within the same city or town, the scale would be uniform and the correspondence, as nearly as may be, complete. Administered locally, it is hard to imagine a more expedient form of taxation. High praise is due to the Massachusetts commission for having brought this subject before the public in a way that is likely to excite its intelligent discussion.

A word may be added regarding the incidence of the proposed tax

¹ Report, p. 106.

² *Science des finances*, vol. i. p. 374.

on rentals. On the face of it, it looks like an addition to the taxes already levied on real estate. And so it is, but the burden will not be upon the owner. With rents exempt up to \$400, and taxation only on the excess, the tax would amount to too little, even at a 10 per cent. rate, to cause any appreciable change in the selection of dwellings; without which, there could be no shifting backwards of any part of the tax to the owner. It would almost inevitably stay where it was first imposed, thus discharging its intended function of a tax on presumed income, among the comfortable and well-to-do.

The farming districts and the smaller manufacturing towns would not be much affected by the new taxes. These would be collected almost entirely in the cities and larger towns. For the farming towns the property tax would continue to be the chief tax, and no change is thought necessary in its basis.¹ On the other hand, their burdens would be considerably lightened by their participation in the proceeds of the inheritance tax. There might seem to be some question as to the right of these communities to share in revenue to which they would contribute little or nothing. But they are overtaxed now and are fairly entitled to milder treatment. With diminished resources, their expenses have gone on increasing, and are largely incurred for purposes, *e. g.*, maintenance of schools and support of the poor, not strictly local in character, but of concern to the state at large. The commission was abundantly justified, therefore, in virtually exempting them from the operation of the new taxes, and even in going so far as to make them beneficiaries under the proposed changes.

Such are the principal features of this able report. The changes recommended present a compact and carefully co-ordinated scheme of taxation, which, if adopted, would probably be found simple and effective in its working, and fairly equitable in the resulting distribution of burdens. The conclusions of the commission are supported at every point by clear and, frequently, convincing reasoning; and are always stated in faultless English. No other report evinces such mastery of its subject, nor keeps its discussions so habitually within the region of real matter. And no other commission, in framing its sys-

¹ With true historical insight, the commission remarks that "the general property tax, which was first put into effect in this country under industrial conditions very similar to those which we now find in a farming town, works well under these conditions, but becomes more and more difficult of satisfactory application as property becomes larger in quantity and more complex in character."—*Report*, p. 52.

tem, has shown so studied a regard for the rights of taxation of other states. On the question of interstate taxation, the commission says:

The circumstance that Massachusetts is one of the great nation of the United States increases the complexities of her industrial life, and causes peculiar difficulties in the selection of appropriate methods of taxation. The ownership of property is intertwined between the citizens of the several states; and each state, inevitably, is desirous of making sure that its own citizens shall make full contributions, and that its own fiscal needs shall be fully met. We have tried to devise a system of taxation which shall not trench on the field which should fairly be left to other jurisdictions. . . . We have tried to recommend changes which, if followed in other states as well, would not cause double taxation. . . .

It is because of the difficulties of adjustment with relation to other states that we have proposed no changes that single out, for separate taxation, property or evidences of property outside of the commonwealth. We have said elsewhere that the holders of such property, spending and enjoying incomes within our borders, should contribute in some degree to our public burdens. But we have thought it best to make recommendations for their taxation, not merely because and in so far as they are owners of foreign property or foreign securities, but because and in so far as their general means enable them to pay taxes. . . . We have proceeded on the assumption that property situated outside of the state already pays, as property, taxes wherever situated, and that it is the concern of the state where it exists to tax it there. Within our jurisdiction, we propose to continue the taxation of property as such; and, further, we propose to tax persons of means, whatever form or source their means may have. We hope thus to secure an adequate revenue by a general system of taxation adjusted fairly both with reference to other states and with reference to the different classes of society in our own state.¹

This is an admirable statement of the true principle of interstate taxation and shows a fine spirit of comity toward the sister states. If acted on by the different states it would not only do away with most of the questions of double taxation, but would also lead to an equitable division of taxes among the states. Of all the annoyances and injustices that have grown up under the system of the property tax, none have been more persistent or irritating than the cases of double taxation by competing states. And yet none can be so easily remedied if the question be only correctly understood. "Properly viewed," the commission puts it, "the question is, not *whether* a man's property is to be taxed, but *where* and in what manner it is to be taxed."² The

¹ Report, p. 111.

² *Ibid.*, p. 85.

evil is most manifest in connection with the taxation of corporate property and securities. Different states follow different and conflicting principles. Some follow the rule of *situs*, taxing only property actually within their borders, others—and they are more numerous—follow the rule *mobilia personam sequuntur*, taxing corporations on the whole of their property or capital no matter where situated or employed. The result is often taxation by different states of the same property or capital. And there is the same divergence of principle in the taxation of securities. Indeed, it sometimes happens that the same state taxes domestic corporations on the whole of their capital no matter where employed, and at the same time taxes the securities of foreign corporations held within the state. This is the present *status* in Massachusetts. It is obviously inconsistent and grievously unfair. The natural and simple way of adjusting all of these cases is that suggested by the commission: Where property owned by Massachusetts citizens is outside the state, it should contribute, as in fact it does, to the public burdens of the community where it exists, and where it enjoys the benefits of government activity. Within the state, those citizens should be called upon to contribute in some way to the public burdens, not with respect to the property itself, but with respect to the income which they here receive and enjoy from their foreign investments.¹ This is the modern doctrine of economic interest applied to the division of taxation between competing authorities, and it has been made the basis of some of the most important changes proposed by the Massachusetts commission. The commission has stopped short, however, of a complete application of its principle, for it proposes to leave Massachusetts corporations still subject to taxation on the whole of their capital irrespective of the place of its employment. This is illogical, but, perhaps, unavoidable at present.

It is to be regretted—and this brings one to notice some of the shortcomings of the report—that the commission did not recommend some changes in the method of taxing corporations. Massachusetts is behind several of the states in this respect. Corporations are taxed locally on their real estate and machinery, and, by the state, on the excess of value as represented by the capital stock at its market price. Special provisions are made for banks and railroads. But the general basis is substantially the same, capital stock at market value. Bonds are not included in making the valuation, although under the present law provision is

¹ Report, p. 82.

made for taxing them in the hands of the bondholder. But as the proposed abolition of taxes on intangible personality will remove this provision, the net effect of the changes contemplated would be a still further discrimination in favor of the bondholder. This is illogical and unjust. From the standpoint of finance there is no difference between stocks and bonds. As the commission itself has said in another connection, "Stocks and bonds, while legally different, are practically alike in being evidences of interest in some tangible property."¹ They are not related as ownership and debt; they are both liabilities of the corporation, indistinguishable except in form. If valuation is to be made the basis of corporate taxation, it should take in bonds as well as stock; otherwise heavily bonded corporations would escape a part of their legitimate taxes. The Pennsylvania method recognizes this, and is thus nearer the true principle of corporate taxation. Again, there would seem to be no solid ground for exempting from the valuation of corporations real estate locally taxed. Taxation by the state and by the local bodies is not one and the same. As a corporation, earning and paying interest and dividends, the corporation should be taxed by the state on the whole of its taxable capacity, as indicated by earnings or valuation. As a land-owner, receiving benefits from, and occasioning expenditures by, local government, the corporation should contribute to the local burdens. This may be double taxation, but it is not unjust. The corporation sustains one relation to state government, another and a different one to local government; it is properly taxable in each of these separate capacities.

Whether the omission of any special provision for the taxation of mortgages is a serious defect in the plan of the commission, is not easy to say. Views differ on the question of mortgage taxation. The movement in favor of a separate and effective taxation of mortgage securities, as the recent reports show, however, is undeniably strong; but no method has yet been accepted as satisfactory. Under the present system of Massachusetts, which began in 1881, mortgages are virtually exempted. The theory of the law is that there shall be but one tax on mortgaged real estate, and no separate taxation of the mortgagee. The borrower and lender are left to arrange between themselves the payment of the taxes, with the practical result that payment by the borrower is commonly stipulated for in mortgages.

¹ *Report*, p. 81.

This system the commission proposes to leave unchanged, believing that it effects a fairly equitable adjustment of the burden on real estate between mortgagor and mortgagee. "We believe," says the commission, "that the change in the tax law made in 1881 has tended to bring about a decline in the rate of interest on mortgages, security being the same; and this decline has been as great as could be expected in view of the conditions prevailing at the time when the law was changed."¹ If, as is implied in this statement, the mortgage part of the tax is shifted to the lender, no change in the present law is necessary. But no evidence is offered in support of the contention, and it is challenged in the minority report, where the attempt is made to prove that the decline in mortgage rates has not been substantially greater in Massachusetts than in neighboring states, under similar conditions, without any change of law.² It may be doubted, therefore, whether Massachusetts has found the most expedient solution of the question of mortgage taxation, taking the commonly accepted view, that the object of solution is the discovery of some effective method of taxing mortgage holders. The California method, which treats the mortgage as evidence of a proprietary interest in the property, and taxes the mortgagee in proportion to his interest, is more correct in theory, and would be more successful in practice if conditions were not against it. In California, as in Massachusetts, but one tax is levied on mortgaged property, but it is divided between the mortgagor and the mortgagee in proportion to their respective interests. The California method attempts to do directly what the Massachusetts system leaves to the uncertain process of shifting; and, so far, is better. It is a commonplace in taxation that a tax is very apt to stick where it is first imposed, and the application to the matter in question is to tax mortgages in the hands of the mortgagee. If, as the commission believes, present circumstances in Massachusetts favor the shifting of the tax to the lender, *a fortiori* they would tend to keep the tax there if originally levied on him. The borrower's chances, to say the least, are better under the latter system. It is illogical for the commission to tell us, in almost the same breath, that the Massachusetts system "has tended to bring about a decline in the rate of interest on mortgages," and that "the taxation of mortgages by a certain and unfailling process would bring about a rise in the interest charge at least to the extent of the tax."³ They express the latter conviction "in view

¹ Report, p. 37.

² *Ibid.*, p. 218.

³ *Ibid.*, pp. 37, 39.

of the experience of California, and of the general probabilities of the case." But the general probabilities are certainly the other way if the first statement be true; and the experience of California is not particularly in point in Massachusetts. Let it be true that "as compared with other loans and investments in California, mortgages there usually bear 2 per cent. additional interest,"¹ what does this show but the futility of trying to tax capital in one form, while leaving it practically free in other forms? If "other loans and investments in California" paid their taxes, mortgages would not "usually bear 2 per cent. additional interest." Does the commission believe that the adoption of the Massachusetts method in California would effect a reduction of 2 per cent. in mortgage rates in that state? If not, what becomes of the soundness of its defense of the Massachusetts method? The fact is that the commission has not displayed its usual acumen and insight in the treatment of this question. The failure of the mortgage tax in California is not due to any error in the method of that tax, but to the unspeakable defects in the other parts of the system of the general property tax, as administered in that state, and in almost every other state of the Union. If the mortgage tax were supported by equally well-arranged taxes on corporations, business, and the other original sources of income, there would be no such record of failure to be noted. The mortgage tax seems destined to become one of the system of separate taxes that will eventually replace the general property tax, and the California tax should supply the model. There seems to be room for the criticism, therefore, that the commission was not alive to its opportunities for proposing useful changes, in the taxation of mortgages, as well as in that of corporations. Nor is it an adequate defense of the omission to say that the taxation of mortgage holders is provided for under the general taxes on rentals and inheritance proposed. The merchant, the manufacturer, the land-owner, and the shareholder will also be subject to these taxes; and, in addition, each will have his special taxes. The omission of a special mortgage tax is, therefore, a real one.

Reference has been made to business as likely to supply one of the separate objects of taxation in the tax system of the future. The

¹ "The additional interest so charged is higher than the tax rate, for the lenders on mortgages are able to secure not only enough to compensate them for the taxes imposed, but something more by way of insurance against possible future rise in the tax rate." — P. 39.

general property tax is destined to be broken up and replaced by taxes upon the separate sources of income. This has been the history of the property tax in every European country, and the process of disintegration has already begun here. Experience also shows that the gap between the property tax of the past and the more perfect forms of income taxation, which the science of finance points to as the ideal for the future, is regularly bridged by the system of taxes on product or earnings. We are now entering this stage of development in the United States. The corporation tax has come, the mortgage tax is approaching, and the business tax must follow. Our present method of taxing business is as crude and antiquated as the rest of the property tax. Merchandise and machinery are no measure of the earning capacity of a business, a closer approximation is needed. This is fully appreciated by the commission, which writes:

To tax stock in trade rigorously, in accord with the letter of the law, would bring about injustice as between different business enterprises. No deduction from the assessed stock in trade is allowed for debts. Doubtless this is the best course, at all events the only possible course; for to allow such deduction would open the door to fraud and evasion through real, fictitious, or adroitly arranged debts. This, we understand, is the consequence of allowing deduction for debts from all personal property in the state of New York. On the other hand, to tax business men strictly and unerringly according to their precise stock in trade, irrespective of liabilities, might result in great inequalities. Of two merchants having the same stock, one may have a considerable capital and no debts, while the other may do business largely on borrowed capital and may be subject to a heavy interest charge. Of two businesses of the same size and profit, one may have a rapid turnover and a comparatively small stock at any one time, while the other may have a slow turnover and a larger stock. In these cases and in countless others which can readily be imagined, taxation precisely in proportion to stock in trade would be unequal and unsatisfactory.¹

And on the taxation of machinery the commission adds:

As in the case of stock in trade, something about it can be ascertained by the assessors without difficulty—its existence, at least, and a rough idea of its value. The exact value of machinery is, indeed, as difficult to judge as the exact value of a merchant's stock. The changes by invention, changes in fashion, in demand for goods made, in the general state of trade, make it almost impossible to ascertain that fair cash value which the tax law contemplates.²

¹ Report, p. 54.

² *Ibid.*, p. 55.

It is clear that many factors enter into the determination of the earning, and, therefore, of the tax-paying, capacity of business that are ignored under the present system of the property tax. It must at the same time be admitted that the problem presents very serious difficulties. There is no form of taxable activity in which the element of personal competency plays so large a rôle as in the conduct of business, and its assessment by any direct and accurate process is well-nigh impossible. The taxation of business incomes is the weak spot in every existing income tax. But, however difficult, better results may be expected than those which are generally reached in this country, and some change is unavoidably necessary in this part of our tax system. The commission tells us that in Massachusetts business is assessed with "at least a reasonable approximation to justice;" but their own admissions indicate that, when this is so, it is because the assessors are better than the law. "The size of the premises, the nature of the trade, general repute as to profits and volume of business, give clews as to the relative taxable abilities of different concerns,"¹ that are utilized by the assessors; and, in this way, the defects of the law are in part corrected. The assessors have thus developed the beginnings of a system of business taxation by estimates based on external indications, which is a step in the right direction, and which might have been carried still further by the commission and made the basis of important proposals, with the promise of still better results. Europe shows several examples of this general method of taxing business, whose examination with reference to their practicability under American conditions would have been a highly useful service, for which the commission was well-fitted, to have performed.

Many readers of the report will also notice with regret the absence of any recommendations for the special taxation of so-called public-service corporations. Street railways, lighting, and telephone service are familiar examples of these quasi-public corporations. It is not denied by the commission that the special privileges and franchises enjoyed by these corporations frequently secure them excessive profits. But it is maintained that other than questions of taxation pure and simple are involved in the settlement of the problem presented by these corporations; and that the questions of taxation cannot be separately treated.² It is no doubt true that the problem thus presented is a large one, involving many considerations that lie beyond the

¹ Report, p. 54.

² *Ibid.*, p. 76.

domain of taxation, and yet there are certain phases of it with which the tax system seems quite competent to deal. Pending the decision of the larger issues at stake, there would seem to be both room and need for special taxation. The commission has more than once stated its acceptance of the doctrine of contribution in proportion to means, and it probably would not deny the propriety of inquiring into the character and source, as well as the amount, of means. The franchise privileges of public-service corporations are a most important factor in their earnings, they give them opportunities of gain not possessed by others, they are an element of their taxable strength, and, on mere grounds of equity in taxation, they ought to be taxed. The commission has not hesitated to justify the taxation of inheritance as a "gratuity,"¹ but what is more gratuitous than an uncompensated valuable franchise? The disposition of the commission to avoid questions of general social policy in the discussion of the tax question is commendable, but in this particular case it has taken too narrow a view of the province of taxation. There are many persons who, without any thought of suggesting changes in the social order, yet advocate the special taxation of these corporations on purely fiscal grounds. An important financial resource might be opened in this way for many an American city, whose activities are now limited for want of means. Doubtless the arrangement of a satisfactory plan for this sort of taxation would not be an easy undertaking. Allowance would have to be made for the special nature and privileges of different kinds of corporations. But these are among the questions on which the ingenuity of a commission may be profitably expended.

The question of a single land tax was discussed before the commission and its adoption urged with great persistence. The advocates of this form of taxation are numerous and enthusiastic in Massachusetts. But the commission rejected their proposals, stating its reasons in a paragraph that deserves to be set by the side of the spirited passage on the fundamental nature and justification of taxation contained in the Massachusetts report of 1875, for the discriminating sense it reveals of what is, and what is not, appropriate matter for discussion in an investigation that has to do, first and last, with questions of taxation. It reads:

We have great respect for the earnest intentions and public spirit of the men who have advocated this plan. But we do not believe that any extended

¹ *Report*, p. 97.

comment on it is called for, or any detailed statement of the reasons for not recommending its adoption. It proposes virtually a radical change in the ownership of land, and, therefore, an entire revolution in the entire social body. In this form of taxation all revenue from land is to be appropriated ; that is, all beneficial ownership of land is to cease. Whether or not this system, if it had been adopted at the outset and had since then been maintained, would have been to the public advantage, may be an open question ; but it would certainly seem too late now to turn to it, in the manner proposed. In any event, it involves properly not questions of taxation, but questions as to the advantage or disadvantage of private property in land. We believe that the general court, in providing for this commission, desired rather information and discussion as to the tax system in its working under existing social conditions than consideration of the abstract justice and the general expediency of private ownership of land. We propose, therefore, to leave this subject to be discussed before the legislature and the public as one of the fundamental problems of society, involving much more than taxation, and to confine ourselves to the narrower but sufficiently difficult subject of the best modes of taxation on property as it is now organized, and now recognized by law.¹

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¹ *Report*, p. 75.